

Products Update



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From Waterloo to St Paul's



Four years after the *Pilkington*¹ case about the failed glazing at the former Eurostar terminal, *Seele Austria GmbH & Co v Tokio Marine Europe Insurance Limited*² continues the theme of when a defect causes damage, and when there may be cover for mere defects.

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Seele was subcontracted to design and install 'punched' windows in a development at Paternoster Square next to St Paul's Cathedral. Tokio Marine provided combined Contract Works and Third Party Liability cover for the building project.

Following installation, the windows were tested for water penetration. This revealed defects in the seals that allowed water to enter the building. To allow access to the defective windows for remedial works, external cladding and internal finishes, including ceilings, floors and plasterboard, had to be opened up and replaced.

Policy

Seele had the benefit of cover under the policy for loss of or damage to insured property unless a policy exclusion applied.

Memorandum 18 stated this included damage arising out of a defect in design, workmanship or materials other than in respect of

- (1) the cost necessary to replace, repair or rectify insured property which was defective in design, materials or workmanship, and what could be described as "access damage", namely loss or damage caused to insured property to enable replacement, repair or

rectification of defective property. If the defect had caused damage to insured property other than access damage, the exclusion was limited to the cost of any additional work needed to improve the original design.

- (2) the cost necessary to replace, repair or rectify insured property which was in a defective condition due to a defect in design, materials or workmanship and insured property lost or damaged to enable replacement, repair or rectification of such defective insured property. This was not to apply to other insured property which was not

defective but was unintentionally damaged as a consequence of the defect in design, materials or workmanship.

- (3) “*The Insurers will additionally indemnify the insured in respect of intentional damage necessarily caused to the Insured Property ... to enable the replacement, repair or rectification of Insured Property ... which was in a defective condition...*”

Memorandum 18(3) was the odd man out, since it appeared to be providing cover even though it was in a list of exclusionary provisions.

Court of Appeal decision

The central issue for the Court of Appeal was whether memorandum 18(3) operated as a standalone indemnity for intentional damage caused by remedial works or whether it was conditional on the operation of memorandum 18(2) and provided cover only if the defective insured property caused accidental physical damage either to the defective insured property itself or some other part of the works as a whole.

The Court of Appeal decided by a majority – so it was far from a clear cut point – that memorandum 18(3) provided a standalone indemnity. Accordingly, even without physical damage to the defective insured property or the rest of the works, the damage deliberately caused to gain access for remedial works would be covered.

Comment

The damage to the external cladding and internal finishes to carry out remedial works constituted damage to insured property other than the defective windows. The cost of remedying the defects in the windows and making good the access damage was not covered under memorandum 18(1) or memorandum 18(2) as the defects were not damage and did not cause damage to other parts of the works save for intentional access damage.

As a standalone provision, memorandum 18(3) nonetheless indemnified Seele for making good the intentional access damage.

Whilst the Court of Appeal was essentially undertaking a policy interpretation exercise in relation to memorandum 18(3), the decision is useful in highlighting the distinction between damaged and defective property. The similarities between *Seele* and *Pilkington v CGU Insurance Plc* are striking.

Pilkington involved toughened glass panels incorporated into the roof of the Eurostar terminal at Waterloo. A small number of panels were fractured and costs were incurred in installing safety nets under the remaining panels to prevent risk of injury to the public using the terminal. *Pilkington* sought indemnity from their global liability insurers, CGU. The product liability section of the CGU policy covered “*loss of or physical damage to physical property not belonging to the insured*” caused by an article supplied. *Pilkington* argued that the terminal structure was physically damaged by the installation of the defective glass panels and, accordingly, that the cost of the installation of safety precautions was covered under the CGU policy.

The Court of Appeal held that to trigger cover the insured had to demonstrate some form of damage to property caused by the product, for which purpose a defect in the product itself was not sufficient, and that the loss claimed resulted from the damage to property. As there was no property damage other than to the glass panels themselves, an indemnity would only be available if the incorporation of a defective product into a building constituted damage to property. This was not the case where the defective product had caused no physical harm to the building and functioned effectively with the other components of the building, subject only to the possibility of some future harm.

In *Seele* the Court of Appeal recognised that it may be difficult

to identify the dividing line between defective property and other property in determining whether there has been damage to other property. Where defective products which are easily identifiable are incorporated into buildings or structures, such as those in the *Pilkington* and *Seele*, identifying whether or not there has been damage to property is likely to be straightforward. However, in other cases, the distinction can be less obvious and determining whether the defective product has caused damage to other property, rather than pure financial loss, may be significantly more complex.

Quite where the law will go after Waterloo and St Paul’s remains to be seen, but at least the general principles to apply in cases of this type seem fairly predictable.

¹ *Pilkington UK Ltd v CGU Insurance Plc* [2004] EWCA Civ 23

² [2008] EWCA Civ 441

An efficacy exclusion bites

Many product liability policies exclude cover for liabilities arising out of the insured's product failing to perform its intended function. In *John Reilly v National Insurance & Guarantee Corporation Limited*¹ the Commercial Court considered how one such efficacy exclusion should be applied.

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John Reilly was an engineer supplying fire detection and protection equipment. He installed a fire extinguishing system in a customer's factory, but when a fire broke out at the factory, a part of the equipment failed to operate, allowing the fire to cause damage.

Reilly's customer sued and his claim was compromised on terms entitling him to pursue Reilly's Tradesmen Policy insurers, National Insurance & Guarantee (NIG). The policy included product liability cover. However, cover was excluded for claims arising out of "...the failure of any fire or intruder alarm switch gear control panel or machinery to perform its intended function".

Issues

The court was asked to rule on whether the efficacy exclusion applied and, in doing so, considered the following issues.

1. Was there a failure of "machinery"?

It was agreed that the master cylinder, actuator piston or cylinder valve had failed. Reilly argued that none of the parts was, on its own, "machinery". NIG contended the system as a whole was

"machinery" and a failure of the system was a failure of "machinery", regardless of whether the system failure was caused by a failure of components that were not in themselves "machinery".

The court decided in favour of NIG. It was not possible to look at each part of the system in isolation. It did not matter that the root cause was a failure of a part of the system that was not, in itself, "machinery". The system was "machinery" and it had failed.

2. Did the words "fire or intruder alarm" qualify the whole of the exclusion?

Reilly had installed a fire extinguishing system, not a fire or intruder alarm. He contended that the words "fire or intruder alarm" qualified each of the following words in the exclusion. If correct, the exclusion applied only to fire or intruder alarms and not to a fire extinguishing system, such as the one in this case. NIG contended that the exclusion contained a list of separate items, and that it would operate in respect of Reilly's machinery.

Reilly's strongest argument was that, if claims arising out of the

failure of a fire extinguishing system to perform its intended function were excluded, there was effectively no cover under the policy. Such an interpretation would mean the policy had no commercial purpose, which flouted good business sense.

However, the court found against Reilly, preferring NIG's submission that there could still be cover, for example, where a valve blew off causing personal injury or damage to property. On this occasion, there was a failure of machinery and the exclusion operated.

Comment

The court's decision is a useful reminder of the scope of product liability cover. Product liability policies are normally intended to cover tortious liabilities to third parties for personal injury or property damage, but not contractual liabilities, such as a warranty that a product will perform. Where the key risk of a product is non-performance, such as failure to prevent injury or damage, it is highly advisable to check whether the policy provides efficacy cover.

¹ [2008] EWHC 722 (Comm)

All mixed up – extra seminar date

Due to demand, we are re-running our December seminar in January. It will be held at our offices on Thursday 8 January 2009 with registration and coffee from 11.00 to 11.30, seminar and Q&As 11.30 – 12.30, followed by lunch.

Some brief details:

The notorious *Bacardi* decision – concerning the mixing of products – still causes confusion for many people. Alison Clarke and Stuart White will examine what 'physical damage' is, why 'physical damage' is important for both policy coverage and liability, and how 'financial', 'consequential' or 'economic' damage is treated

differently. They will also look at topical issues affecting coverage and liability in a mixing situation, both from the point of view of product liability insurers and property insurers considering subrogation.

If you are interested in attending please email seminars@rpc.co.uk

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